

## Booking Audit Adjustments

### Reaching Agreement on the Audit Adjustments

At the completion of the audit, the auditors *must* meet with the management of the LEA to discuss the proposed audit adjustments. Remember, it is the responsibility of the LEA to prepare all of the financial statements, notes, and schedules. Even if the financial statements, notes, and schedules are prepared for the LEA by the auditors, these items remain the responsibility of the LEA. *Therefore, the LEA must agree to any adjustments that the auditors determine need to be made to the financial statements.*

Only adjustments that are material, or material in combination with other adjustments, should be posted to the financial statements. Materiality has been defined in accounting literature as “of substantial importance, of great consequence, pertinent or essential to, likely to influence.” Unfortunately, there is no handy rule of thumb for determining whether a given item is material. An item which is material to one LEA may not be material to another. Determining materiality requires informed judgment based on the particular facts in each set of circumstances.

In determining whether an item is material and, therefore, should be posted to the financial statements, LEAs should compare the item to the fund balance (although a comparison to revenues or expenditures may also be valid). The following example is offered to illustrate this point:

Assume that in the General Fund, the fund balance at 6/30/xx is:

<b>Reserved Fund Balance</b>	<b>\$ 441,529</b>
<b>Unreserved</b>	<b><u>161,250</u></b>
<b>Total Fund Balance</b>	<b>\$ 602,779</b>

- A. If the auditors find that accounts payable has been understated by \$80,000, they will propose the following entry be made to the financial statements:

<b>DR Expenditures</b>	<b>\$ 80,000</b>	
<b>CR Accounts Payable</b>		<b>\$ 80,000</b>

This is clearly a material adjustment because it will reduce an unreserved fund balance by 50 percent.

- B. If the auditors find that accounts receivable has been overstated by \$3,000, this adjustment would not be made to the financial statements, because in this instance, it does not significantly affect the fund balance.

If there is disagreement about whether an item is material, it is reasonable to expect the auditors to explain why they believe the entry is significant. If the LEA's management is not convinced that the item meets the definition of materiality, they should not agree to the adjustment to the financial statements. *Remember: These are the LEA's financial statements.*

If, in the opinion of the auditors, an item is material and the management of the LEA does not agree that it should be posted to the financial statements, the auditors will modify their opinion on the financial statements to a "qualified" or "adverse" opinion, depending on the significance of the item as determined by the auditors.

After agreement is reached on the items to be posted to the financial statements, the auditors or the LEA will prepare the audited financial statements. One of the schedules in the annual audit report is the "Reconciliation of Annual Financial and Budget Report (J-200/J-400) with Audited Financial Statements." A sample of this schedule is shown on page 607-4. *This schedule shows the impact of the audit adjustments of the fund balance.*

The LEA and the auditors have the following responsibilities in relation to the audit adjustments:

The LEA	The Auditors
<ol style="list-style-type: none"> <li>1. To review all audit adjustments proposed by the auditors</li> <li>2. To reach agreement with the auditors on the adjustments to be made to the LEA's financial statements</li> <li>3. To "book" (record) the audit adjustments which have been agreed on</li> <li>4. To provide information to the auditors on the disposition of the audit adjustments</li> </ol>	<ol style="list-style-type: none"> <li>1. To discuss all proposed audit adjustments with the management of the LEA</li> <li>2. To reach agreement with the management of the LEA on the adjustments that will be made to the LEA's financial statements</li> <li>3. To provide the LEA with a complete set of entries that support the "Reconciliation of Annual Financial and Budget Report (J-200/J-400) with Audited Financial Statements"</li> </ol>

## Suggested Steps for Booking the Audit Adjustments

Once the audit adjustments are agreed on and the financial statements are prepared, the LEA can book the audit adjustments. To facilitate the process of booking the audit adjustments, the California Department of Education developed a work sheet, "Schedule of Audit Adjustments to the \_\_\_\_\_ Fund," and the instructions for using it are shown on page 607-9. The following steps should be followed in booking the audit adjustments:

1. Obtain from the auditors a copy of the “Reconciliation of Annual Financial and Budget Report (J-200/J-400) with Audited Financial Statements.” This schedule shows in summary form the impact of the audit adjustments on the fund balance in each fund. (See sample page 607-4.)

Notice that the schedule on page 607-4 shows that there are audit adjustments in only two funds—the General Fund and the Cafeteria Fund.

2. Obtain from the auditors the detailed entries that support the summary entries on the “Reconciliation of Annual Financial and Budget Report (J-200/J-400) with Audited Financial Statements.” These detailed entries should show the account numbers.
3. Review each detailed adjusting entry and determine whether a portion of the entry was booked in the year following the audit (current year). See the “Schedule of Common Audit Adjustments” on pages 607-6 through 607-8.
4. Determine the entry needed on the books of the LEA to record the audit adjustment. Prepare the “Schedule of Audit Adjustments to the \_\_\_\_\_ Fund.”
5. Post the entries to the books of the LEA.
6. Provide a copy of the “Schedule of Audit Adjustments to the \_\_\_\_\_ Fund” to the auditors to be used in the audit of the current year’s audit.

## The Audit Adjustments and the J-200/J-400 Reports

The total amount of the adjustments to the fund balance that the LEA has booked will appear on the J-200/J-400 reports on the line “Audit Adjustments” in the fund balance section. The “Audit Adjustment” line, in the column “Projected Year Totals,” will be used on the interim reports.

The line “Adjustment for Restatements” is to be used by LEAs to correct a material error reported in the financial statements of a prior year. *It will be used for material errors that are discovered after the completion of the audit.* Any errors discovered by the LEA during the audit should be reported to the auditors for correction in the audited financial statements. Before posting any items to the “Adjustment for Restatements” line, LEAs should consult with their independent auditors.

**Reconciliation of Annual Financial and Budget Report (J-200/J-400) with Audited Financial Statements for Year Ended June 30, 1992**

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	<i>General Fund</i>	<i>Cafeteria Fund</i>
Fund balances per annual financial and budget report (Form J-200)	\$3,538,962	\$394,802
Adjustments increasing (decreasing) fund balances		
Unaccrued compensated absences	(56,000)	
Underaccrued accounts payable	(139,210)	
Overaccrued accounts receivable	(57,603)	(68,276)
Fund balances per audited financial statement	\$3,286,149	\$326,526
There were no adjustments to fund balances for funds not presented above.		

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## **Schedule of Common Audit Adjustments**

The “Schedule of Common Audit Adjustments” on pages 607-6 through 607-8 provides examples of common audit adjustments and the entries that should be made on the books of the LEA to record the audit adjustments.

The following is a description of the three columns in the “Schedule of Common Audit Adjustments”:

### **1. Audit Adjustments**

This column shows the audit adjustments that have been proposed by the auditors, agreed to by the LEA, and posted to the LEA’s audited financial statements. Notice that the entries made by the auditors are made as if the books are still open.

### **2. Processed Transactions**

This column shows the transactions related to the audit adjustments, which have been posted to the books by the LEA (processed) in the current year. These are the transactions that have taken place since the beginning of the year and before the LEA agrees to the audit adjustments.

The processed transactions must be taken into account when preparing the entries needed on the books of the LEA. For example:

Assume that the auditors determine that \$10,000 in federal revenue should have been accrued and was not. The LEA agrees to the audit adjustment, and the following adjustment is made to the LEA's financial statements:

<b>DR</b>	<b>Accounts Receivable</b>	<b>\$10,000</b>	
	<b>CR Revenue</b>		<b>\$10,000</b>

The LEA is ready to book the audit adjustment on October 1, 1992. On September 1, 1989, the LEA received the \$10,000 in federal revenue and since this revenue was not on the accounts receivable list, the LEA recorded it as:

<b>DR</b>	<b>Cash</b>	<b>\$10,000</b>	
	<b>CR Revenue</b>		<b>\$10,000</b>

If this processed transaction was not considered before booking the audit adjustment, the revenue would be recorded twice (once as an audit adjustment and once as a posting to the current year's revenue).

NOTE: For purposes of the entries made in this column, it is assumed that the reversal method is not used for accounts receivable and accounts payable and that the LEA reviews the accounts receivable or accounts payable list before posting the entry.

### 3. Entries Needed on the LEA's Books

This column shows the entries that are needed on the LEA's books to record the audit adjustment.

Notice in this column that when the auditors prepare an audit adjustment to a revenue or expenditure account, the LEA will post the adjustment to *Adjusted Fund Balance* (Account 979X) because the books for the year under audit are closed. Notice also that the entries made in this column take into account any processed transactions.

### Schedule of Common Audit Adjustments

<i>Audit adjustments</i>	<i>Processed transactions*</i>	<i>Entries needed on the LEA's books</i>
<p>1. The auditors determine that a receivable was not set up for a material amount (\$15,000) of revenue earned as of 6/30/xx.</p> <p><b>DR    Accounts Receivable    \$15,000</b>  <b>CR        Revenue                    \$15,000</b></p>	<p>The revenue is received before the audit adjustment is booked. The LEA makes the following entry:</p> <p><b>DR    Cash                            \$15,000</b>  <b>CR        Revenue                    \$15,000</b></p> <p>The revenue is not received before the audit adjustment is booked.</p> <p style="text-align: center;"><b>—No Entry—</b></p>	<p>To book the audit adjustment:</p> <p><b>DR    Accounts Receivable    \$15,000</b>  <b>CR        Adjusted Fund Balance    \$15,000</b></p> <p>To correct processed transaction:</p> <p><b>DR    Revenue                            \$15,000</b>  <b>CR        Accounts Receivable        \$15,000</b></p> <p><b>DR    Accounts Receivable    \$15,000</b>  <b>CR        Adjusted Fund Bal.        \$15,000</b></p>
<p>2. The auditors determine that a receivable (\$40,000) was overstated by \$15,000 as of 6/30/xx.</p> <p><b>DR    Revenue                            \$15,000</b>  <b>CR        Accounts Receivable    \$15,000</b></p>	<p>The revenue is received before the audit adjustment is booked. The LEA makes the following entry:</p> <p><b>DR    Cash                            \$25,000</b>  <b>DR    Revenue                            15,000</b>  <b>CR        Accounts Receivable    \$40,000</b></p> <p>The revenue is not received before the audit adjustment is booked.</p> <p style="text-align: center;"><b>—No Entry—</b></p> <p>* Entries made in this column assume that the reversal method is not used for accounts receivable and accounts payable and that the LEA reviews the lists of accounts receivable or accounts payable before posting the entry.</p>	<p>To book the audit adjustment:</p> <p><b>DR    Adjusted Fund Bal.        \$15,000</b>  <b>CR        Accounts Receivable        \$15,000</b></p> <p>To correct processed transaction:</p> <p><b>DR    Accounts Receivable    \$15,000</b>  <b>CR        Revenue                            \$15,000</b></p> <p><b>DR    Adjusted Fund Bal.        \$15,000</b>  <b>CR        Accounts Receivable        \$15,000</b></p>

### Schedule of Common Audit Adjustments

<i>Audit adjustments</i>	<i>Processed transactions*</i>	<i>Entries needed on the LEA's books</i>
<p>3. The auditors determine that an accounts payable (\$10,000) had been understated by \$15,000.</p> <p><b>DR    Expenditures        \$15,000</b>  <b>CR        Accounts Payable    \$15,000</b></p>	<p>The payable is liquidated before the audit adjustment is booked. The LEA makes the following entry:</p> <p><b>DR    Accounts Payable        \$10,000</b>  <b>DR    Expenditures            15,000</b>  <b>CR        Cash                        \$25,000</b></p> <p>The payable is not liquidated before the audit adjustment is booked.</p> <p><b>–No Entry–</b></p>	<p>To book the audit adjustment:</p> <p><b>DR        Adjusted Fund Bal. \$15,000</b>  <b>CR        Accounts Payable        \$15,000</b></p> <p>To correct processed transaction:</p> <p><b>DR        Accounts Payable        \$15,000</b>  <b>CR        Expenditures               \$15,000</b></p> <p><b>DR        Adjusted Fund Bal.    \$15,000</b>  <b>CR        Accounts Payable        \$15,000</b></p>
<p>4. The auditors determine that an accounts payable (\$25,000) was overstated by \$10,000.</p> <p><b>DR        Accounts Payable    \$10,000</b>  <b>CR        Expenditures            \$10,000</b></p>	<p>The payable is liquidated before the audit adjustment is booked. The LEA makes the following entry:</p> <p><b>DR    Accounts Payable        \$25,000</b>  <b>CR    Expenditures               \$10,000</b>  <b>CR    Cash                         \$15,000</b></p> <p>The payable is not liquidated before the audit adjustment is booked.</p> <p><b>–No Entry–</b></p> <p>* Entries made in this column assume that the reversal method is not used for accounts receivable and accounts payable and that the LEA reviews the lists of accounts receivable or accounts payable before posting the entry</p>	<p>To book the audit adjustment:</p> <p><b>DR        Accounts Payable        \$10,000</b>  <b>CR        Adjusted Fund Bal.       \$10,000</b></p> <p>To correct processed transaction:</p> <p><b>DR        Expenditures               \$10,000</b>  <b>CR        Accounts Payable        \$10,000</b></p> <p><b>DR        Accounts Payable        \$10,000</b>  <b>CR        Adjusted Fund Bal.       \$10,000</b></p>

### Schedule of Common Audit Adjustments

<i>Audit adjustments</i>	<i>Processed transactions*</i>	<i>Entries needed on the LEA's books</i>
<p>5. The auditors determine that revenue (\$25,000) was not earned as of 6/30/xx.</p> <p><b>DR    Revenue                    \$25,000</b>  <b>CR    Deferred Revenue    \$25,000</b></p>	<p align="center"><b>–No Entry–</b></p>	<p><b>DR    Adjusted Fund Bal.    \$25,000</b>  <b>CR    Deferred Revenue       \$25,000</b></p>
<p>6. The auditors determine that \$50,000 in cash that was recorded on the books of the LEA on 6/30/xx was actually not received until 7/2/xx.</p> <p><b>DR    Revenue                    \$50,000</b>  <b>CR    Cash                         \$50,000</b></p>	<p align="center"><b>–No Entry–</b></p>	<p><b>DR    Adjusted Fund Balance \$50,000</b>  <b>CR    Revenue                    \$50,000</b></p>
<p>* Entries made in this column assume that the reversal method is not used for accounts receivable and accounts payable and that the LEA reviews the lists of accounts receivable or accounts payable before posting the entry</p>		



## Preparing the Schedule of Audit Adjustments

Prepare one schedule for each fund that shows audit adjustments on the “Reconciliation of Annual Financial and Budget Report (J-200/J-400) with Audited Financial Statements.”

**Line 1**—Record the audited financial statement’s fund balance per the “Reconciliation of Annual Financial and Budget Report (J-200/J-400) with Audited Financial Statements.”

**Line 2**—Record the fund balance per the LEA’s books and Form J-200/J-400 (as shown on the “Reconciliation of Annual Financial and Budget Report with Audited Financial Statements”).

**Line 3**—Subtract line 2 from line 1.

**Line 4**—Ask your auditors to provide the detailed entries, which support the summary entries on the “Reconciliation of Annual Financial and Budget Report with Audited Financial Statements.” The entries provided by the auditors will be made as if the books are still open (i.e., the auditors will be making entries for revenues and expenditures).

For each entry provided by the auditors, record the impact on fund’s balance in the column “Increase (Decrease) to fund balance.”

**Line 5**—Sum the total of the column “Increase (Decrease) to fund balance.” This total must agree with that on line 3.

**Line 6**—Research each audit adjustment recorded by the auditors (see line 4) to determine whether any portion of the audit adjustment has been posted to the books in the current year. See “Schedule of Common Audit Adjustments,” pages 607-6 through 607-8. Record any processed transaction.

**Line 7**—Record the entries that are needed on the books of the LEA.

*Reminder:* Provide a copy of this schedule to the auditors when it is complete.

## Schedule of Audit Adjustments to the \_\_\_\_\_ Fund

1. June 30, 19xx, fund balance from audited financial statement \$ \_\_\_\_\_
2. Less: Fund balance per LEA 's annual financial report (Form J-200/J-400) - \_\_\_\_\_
3. Computed difference (increase [decrease] in fund balance) = \$ \_\_\_\_\_

### 4. Audit adjustments

<i>Account Number</i>	<i>Description</i>	<i>Increase (Decrease) to Fund Balance</i>
a. _____	DR _____ \$ _____	\$ _____ a.
	CR _____ \$ _____	
b. _____	DR _____ \$ _____	\$ _____ b.
	CR _____ \$ _____	
c. _____	DR _____ \$ _____	\$ _____ c.
	CR _____ \$ _____	
d. _____	DR _____ \$ _____	\$ _____ d.
	CR _____ \$ _____	
e. _____	DR _____ \$ _____	\$ _____ e.
	CR _____ \$ _____	
f. _____	DR _____ \$ _____	\$ _____ f.
	CR _____ \$ _____	
g. _____	DR _____ \$ _____	\$ _____ g.
	CR _____ \$ _____	
h. _____	DR _____ \$ _____	\$ _____ h.
	CR _____ \$ _____	

5. Total increase (decrease) to fund balance\*  
(Sum of lines 4a–4h; must agree with Line 3) \$ \_\_\_\_\_

Date on which copy of work sheet was provided to independent auditor \_\_\_\_\_

\*This figure will agree with the "Audit adjustment" line of Form J-200/J-400.

# **Schedule of Audit Adjustments to the \_\_\_\_\_ Fund (Continued)**

6. Processed transactions

7. Entries needed on LEA's books

6. Processed transactions			7. Entries needed on LEA's books		
<i>Account Number</i>	<i>Description</i>	<i>Amount</i>	<i>Account Number</i>	<i>Description</i>	<i>Amount</i>
a. _____	DR _____	\$ _____	a. _____	DR _____	\$ _____
_____	DR _____	\$ _____	_____	DR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
b. _____	DR _____	\$ _____	b. _____	DR _____	\$ _____
_____	DR _____	\$ _____	_____	DR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
c. _____	DR _____	\$ _____	c. _____	DR _____	\$ _____
_____	DR _____	\$ _____	_____	DR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
d. _____	DR _____	\$ _____	d. _____	DR _____	\$ _____
_____	DR _____	\$ _____	_____	DR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
e. _____	DR _____	\$ _____	e. _____	DR _____	\$ _____
_____	DR _____	\$ _____	_____	DR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
f. _____	DR _____	\$ _____	f. _____	DR _____	\$ _____
_____	DR _____	\$ _____	_____	DR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
g. _____	DR _____	\$ _____	g. _____	DR _____	\$ _____
_____	DR _____	\$ _____	_____	DR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
h. _____	DR _____	\$ _____	h. _____	DR _____	\$ _____
_____	DR _____	\$ _____	_____	DR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____
_____	CR _____	\$ _____	_____	CR _____	\$ _____

